certain persons related to Cox Communications or Advance/Newhouse would acquire shares of, or other interests (including options) in our capital stock or (3) any action or failure to act by us or any of our subsidiaries following the completion of the spin off that would be inconsistent with, or otherwise cause any person to be in breach of, any representation or covenant made in connection with the tax opinion delivered to LMC by Skadden, Arps, Slate, Meagher & Flom LLP or the private letter ruling obtained by LMC from the IRS, in each case relating to, among other things, the qualification of the spin off as a tax-free transaction described under Sections 355 and 368(a)(1)(D) of the Code. Please see "Certain Inter Company Agreements—Agreements with LMC—Tax Sharing Agreement" for a more detailed discussion of the tax sharing agreement between our company and LMC.

Treasury Regulations under Section 355 of the Code require that each LMC shareholder who receives shares of our common stock pursuant to the spin off attach a statement to the U.S. federal income tax return that will be filed by the shareholder for the taxable year in which such shareholder receives the shares of our common stock in the spin off, which statement shows the applicability of Section 355 of the Code to the spin off. LMC will provide each holder of LMC common stock with the information necessary to comply with this requirement.

Results of the Spin Off

Immediately following the spin off, we expect to have outstanding approximately 268 million shares of our Series A common stock and approximately 12 million shares of our Series B common stock, based upon the number of shares of LMC Series A common stock and LMC Series B common stock outstanding on April 29, 2005. The actual number of shares of our Series A common stock and Series B common stock to be distributed in the spin off will depend upon the actual number of shares of LMC Series A common stock and LMC Series B common stock outstanding on the record date.

Immediately following the spin off, we expect to have approximately 4,583 holders of record of shares of our common stock, based upon the number of record holders of LMC common stock on April 29, 2005 (which amount does not include the number of shareholders whose shares are held of record by banks, brokerage houses or other institutions, but includes each such institution as one shareholder).

Listing and Trading of our Common Stock

On the date of this information statement, we are a wholly owned subsidiary of LMC. Accordingly, there is currently no public market for our common stock. We have applied to list our shares of Series A common stock and Series B common stock on the Nasdaq National Market under the symbols "DISCA" and "DISCB," respectively. Following the spin off, LMC Series A common stock and LMC Series B common stock will continue to trade on the New York Stock Exchange under the symbols "L" and "LMC.B," respectively.

Neither we nor LMC can assure you as to the trading price of either series of our common stock after the spin off or as to whether the combined trading prices of a series of our common stock and the same series of LMC's common stock after the spin off will be less than, equal to or greater than the trading prices of that series of LMC's common stock prior to the spin off. See "Risk Factors—Factors Relating to Our Common Stock and the Securities Market."

The shares of our common stock distributed to LMC's shareholders will be freely transferable, except for shares received by individuals who are our affiliates and any shares distributed in respect of any LMC restricted stock. Individuals who may be considered our affiliates after the spin off include individuals who control, are controlled by or are under common control with us, as those terms generally are interpreted for federal securities law purposes. This may include some or all of our executive officers and directors. Individuals who are our affiliates will be permitted to sell their shares of our common stock only pursuant to an effective registration statement under the Securities Act of

1933, as amended, or an exemption from the registration requirements of the Securities Act, such as the exemptions afforded by Section 4(2) of the Securities Act or Rule 144 thereunder. Our affiliates will not be permitted to sell shares of our common stock under Rule 144 until 90 days after the date on which the registration statement of which this information statement forms a part became effective.

Trading Between the Record Date and Distribution Date

Between the record date and the distribution date, LMC common stock will continue to trade on the NYSE in the regular way market. During this time, shares of either series of LMC common stock that trade on the regular way market will trade with an entitlement to receive shares of the same series of our common stock distributable in the spin off. No ex-dividend market will be established until the distribution date. Therefore, if you own shares of either series of LMC common stock on the record date and thereafter sell those shares prior to the distribution date, you will also be selling the shares of our common stock that would have been distributed to you in the spin off with respect to the shares of LMC common stock you sell. On the distribution date, shares of LMC Series A common stock and LMC Series B common stock will begin trading without any entitlement to receive shares of our common stock. Shares of LMC Series A common stock and LMC Series B common stock trade under the symbols "L" and "LMC.B," respectively.

On July 8, 2005, when-issued trading in our Series A common stock commenced on the OTC Bulletin Board under the symbol "DCHAV." As of the date hereof, there are no plans for our Series B common stock to trade on a when-issued basis, but a when-issued trading market in our Series B common stock may develop between the record date and the distribution date. Our Series A and Series B common stock is expected to be listed for trading on the Nasdaq National Market. The when-issued trading market, if any, is a market for the shares of our common stock that will be distributed in the spin off. If you own shares of either series of LMC common stock on the record date (and do not sell those shares of LMC common stock before the distribution date), then you are entitled to a number of shares of the same series of our common stock based upon the number of shares of such series of LMC common stock you held at that time. You may trade this entitlement to receive shares of our common stock, without the shares of LMC common stock you own, on the when-issued trading market. We expect when-issued trades of our common stock to settle within two trading days after the distribution date. On the distribution date, any when-issued trading with respect to our common stock will end and regular way trading will begin. The listing for our common stock for when-issued trading, if any, is expected to be under trading symbols different from our regular way trading symbols. The trading symbol for our Series A common stock that trades on a when-issued basis is "DCHAV." We will announce the when-issued trading symbol for the Series B common stock when and if it becomes available. On the distribution date, shares of our Series A common stock and Series B common stock are expected to be listed under the trading symbols "DISCA" and "DISCB," respectively. If the spin off does not occur, all when-issued trading will be null and void.

Reasons for Furnishing this Information Statement

This information statement is being furnished solely to provide information to LMC shareholders who will receive shares of our common stock in the spin off. It is not and is not to be construed as an inducement or encouragement to buy or sell any of our securities or any securities of LMC. We believe that the information contained in this information statement is accurate as of the date set forth on the cover. Changes to the information contained in this information statement may occur after that date, and neither our company nor LMC undertakes any obligation to update the information except in the normal course of our respective public disclosure obligations and practices.

CAPITALIZATION

The following table sets forth (1) our historical capitalization as of March 31, 2005 and (2) our adjusted capitalization assuming the spin off was effective on March 31, 2005. The table should be read in conjunction with our historical combined financial statements, including the notes thereto, and "*Management's Discussion and Analysis of Financial Condition and Results of Operations*" included elsewhere herein.

	March 31, 2005	
	Historical	As adjusted
	amounts in thousands	
Cash(1)	$ 15,181	215,181
Payables, accruals and other liabilities	$ 125,115	125,115
Deferred tax liabilities	1,091,985	1,091,985
Total liabilities	1,217,100	1,217,100
Equity:		
Common Stock ($.01 par value):		
Series A; 600,000,000 shares authorized; 267,895,063 assumed issued on a pro forma basis	—	2,679
Series B; 50,000,000 shares authorized; 12,106,282 assumed issued on a pro forma basis	—	121
Series C; 600,000,000 shares authorized; no shares assumed issued on a pro forma basis	—	—
Additional paid-in capital	—	5,705,074
Accumulated other comprehensive earnings	7,008	7,008
Accumulated deficit	(1,154,272)	(1,154,272)
Parent's investment	5,507,874	—
Total equity(1)	4,360,610	4,560,610
Total liabilities and equity	$ 5,577,710	5,777,710

(1) LMC has agreed to transfer to a subsidiary of our company $200 million of cash prior to the spin off.

SELECTED FINANCIAL DATA

The following tables present selected historical information relating to our combined financial condition and results of operations for the three months ended March 31, 2005 and 2004 and for the past five years. The financial data for the three years ended December 31, 2004 has been derived from our audited combined financial statements for the corresponding periods. Data for the other periods presented has been derived from unaudited information. The data should be read in conjunction with our combined financial statements and *"Management's Discussion and Analysis of Financial Condition and Results of Operations"* included elsewhere herein.

	March 31, 2005	December 31, 2004	2003	2002	2001	2000
			amounts in thousands			
Summary Balance Sheet Data:						
Investment in Discovery	$2,966,139	2,945,782	2,863,003	2,816,513	2,899,824	3,117,877
Property and equipment, net	$ 261,603	258,741	257,536	300,496	316,077	366,944
Intangible assets, net	$2,140,551	2,140,355	2,136,667	2,112,544	2,043,011	2,315,164
Total assets	$5,577,710	5,564,828	5,396,627	5,373,150	5,399,702	5,954,668
Debt, including current portion	$ —	—	—	401,984	443,685	408,437
Subordinated notes payable to LMC	$ —	—	—	205,299	183,685	92,454
Parent's investment	$4,360,610	4,347,279	4,260,269	3,617,417	3,578,364	4,093,150

	Three months ended March 31, 2005	2004	Years ended December 31, 2004	2003	2002	2001	2000(1)
				amounts in thousands			
Summary Statement of Operations Data:							
Revenue	$174,290	145,943	631,215	506,103	539,333	592,732	295,717
Operating income (loss)(2)	$ 2,877	5,914	16,935	(2,404)	(61,452)	(350,628)	(62,209)
Share of earnings (loss) of Discovery(3)	$ 22,814	10,449	84,011	37,271	(32,046)	(277,919)	(326,710)
Net earnings (loss)(2)	$ 16,825	11,920	66,108	(52,394)	(129,275)	(608,261)	(303,757)
Unaudited pro forma basic and diluted net earnings (loss) per common share(4)	$ 0.06	0.04	0.24	(0.19)	(0.46)	(2.17)	(1.08)

(1) Ascent Media was initially formed by LMC in connection with its acquisitions of Four Media Company in April 2000 and The Todd-AO Corporation in June 2000. Accordingly, the 2000 statement of operations data includes amounts from those dates. See "Description of our Business—Ascent Media".

(2) Includes impairment of goodwill and other long-lived assets of $51,000, $562,000, $83,718,000 and $307,932,000 for the years ended December 31, 2004, 2003, 2002 and 2001, respectively.

(3) Effective January 1, 2002, we adopted Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, which among other matters, provides that excess costs that are considered equity method goodwill are no longer amortized, but are evaluated for impairment

under APB Opinion No. 18. Share of losses of affiliates includes excess basis amortization of $188,570,000 and $186,563,000 for the years ended December 31, 2001 and 2000, respectively.

(4) Unaudited pro forma basic and diluted net earnings (loss) per common share is based on 280,001,000 common shares for the three months ended March 31, 2005 and 2004 and 279,996,000 common shares for the years ended December 31, 2004, 2003 and 2002, which is the number of shares that would have been issued on March 31, 2005 and December 31, 2004, respectively, if the spin off had been completed on such dates.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis provides information concerning our results of operations and financial condition. This discussion should be read in conjunction with our accompanying combined financial statements and the notes thereto included elsewhere herein.

Management's Discussion and Analysis of Financial Condition and Results of Operations of Discovery Holding

Overview

We are a holding company and our businesses and assets include Ascent Media, which we consolidate, and a 50% ownership interest in Discovery, which we account for using the equity method of accounting. Accordingly, as described below, Discovery's revenue is not reflected in the revenue we report in our financial statements. In addition to the foregoing assets, immediately prior to the spin off, LMC will transfer to a subsidiary of our company $200 million in cash. On March 15, 2005, LMC announced its intention to spin off all of our capital stock to the holders of LMC Series A and Series B common stock. The spin off will be effected as a distribution by LMC to holders of its Series A and Series B common stock of shares of our Series A and Series B common stock. The spin off will not involve the payment of any consideration by the holders of LMC common stock and is intended to qualify as a tax-free spinoff. The spin off is expected to be accounted for at historical cost due to the pro rata nature of the distribution. The spin off is expected to occur on July 21, 2005, and will be made as a dividend to holders of record of LMC common stock as of the close of business on July 15, 2005.

Following the spin off, we and LMC will operate independently, and neither will have any stock ownership, beneficial or otherwise, in the other.

Ascent Media provides creative, media management and network services to the media and entertainment industries. Ascent Media's clients include major motion picture studios, independent producers, broadcast networks, cable programming networks, advertising agencies and other companies that produce, own and/or distribute entertainment, news, sports, corporate, educational, industrial and advertising content. Ascent Media's operations are organized into the following four groups: creative services, media management services, network services and corporate and other. Ascent Media has few long-term or exclusive agreements with its creative services and media management services customers.

In 2005, Ascent Media intends to focus on leveraging its broad array of media services to market itself as a full service provider to new and existing customers within the feature film and television production industry. With facilities in the U.S., the United Kingdom and Asia, Ascent Media also hopes to increase its services to multinational companies. The challenges that Ascent Media faces include differentiating its products and services to help maintain or increase operating margins and financing capital expenditures for equipment and other items to satisfy customers' desire for services using the latest technology.

Our most significant asset is Discovery, in which we do not have a controlling financial interest. Discovery is a global media and entertainment company that provides original and purchased video programming in the United States and over 160 other countries. We account for our interest in Discovery using the equity method of accounting. Accordingly, our share of the results of operations of Discovery is reflected in our combined results as earnings or losses of Discovery. To assist the reader in better understanding and analyzing our business, we have included a separate discussion and analysis of Discovery's results of operations. See "—Management's Discussion and Analysis of Financial Condition and Results of Operations of Discovery."

Acquisitions and Dispositions

Cinetech. On October 20, 2004, Ascent Media acquired substantially all of the assets of Cinetech, Inc., a film laboratory and still image preservation and restoration company, for $10,000,000 in cash plus contingent compensation of up to $1,500,000 to be paid based on the satisfaction of certain contingencies as set forth in the purchase agreement. Cinetech is included in Ascent Media's media management services group.

London Playout Centre. On March 12, 2004, Ascent Media acquired the entire issued share capital of London Playout Centre Limited, which we refer to as LPC, a UK-based television channel origination facility. LPC is included in Ascent Media's network services group.

Sony Electronics' System Integration Center. On December 31, 2003, Ascent Media acquired the operations of Sony Electronic's systems integration center business and related assets, which we refer to as SIC. In exchange, Sony received the right to be paid an amount equal to 20% of the value of the combined business of Ascent Media's wholly owned subsidiary, AF Associates, Inc. and SIC. The value of 20% of the combined business of AF Associates and SIC was estimated at $6,000,000. SIC is included in Ascent Media's network services group.

Triumph. On December 23, 2002, Ascent Media sold to Leafco Communications, Inc. all of its equity interest in Triumph Communications, Inc. and certain related entities for nominal consideration plus the assumption of net liabilities in the amount of $4,000,000. Triumph was included in Ascent Media's network services group.

Operating Cash Flow

We evaluate the performance of our operating segments based on financial measures such as revenue and operating cash flow. We define operating cash flow as revenue less cost of services and selling, general and administrative expense (excluding stock and other equity-based compensation). We believe this is an important indicator of the operational strength and performance of our businesses, including the ability to invest in ongoing capital expenditures and service of any debt. In addition, this measure allows management to view operating results and perform analytical comparisons and identify strategies to improve performance. This measure of performance excludes depreciation and amortization, stock and other equity-based compensation, restructuring and impairment charges that are included in the measurement of operating income pursuant to U.S. generally accepted accounting principles, or GAAP. Accordingly, operating cash flow should be considered in addition to, but not as a substitute for, operating income, cash flow provided by operating activities and other measures of financial performance prepared in accordance with GAAP.

Results of Operations

Our combined results of operations include general and administrative expenses incurred at the DHC corporate level, 100% of Ascent Media's results and our 50% share of earnings of Discovery.

Ascent Media's creative services group revenue is primarily generated from fees for video and audio post production, special effects and editorial services for the television, feature film and advertising industries. Generally, these services pertain to the completion of feature films, television programs and advertisements. These projects normally span from a few days to three months or more in length, and fees for these projects typically range from $10,000 to $1,000,000 per project. The media management services group provides owners of film libraries a broad range of restoration, preservation, archiving, professional mastering and duplication services. The scope of media management services vary in duration from one day to several months depending on the nature of the service, and fees typically range from less than $1,000 to $100,000 per project. Additionally, the media management services group includes Ascent Media's digital media center which is developing new products and businesses in areas such as digital imaging, digital media and interactive media. The network services group's revenue consists of fees relating to facilities and services necessary to assemble and transport programming for cable and broadcast networks across the world via fiber, satellite and the Internet. Additionally, the group's revenues are also driven by systems integration and field support services, technology consulting services, design and implementation of advanced video systems, engineering project management, technical help desk and field service. Approximately 40% of network services group's revenue relates to broadcast services, satellite operations and fiber services that are earned monthly under long-term contracts ranging generally from one to seven years. Additionally, approximately 30% of revenue relates to systems integration and engineering services that are provided on a project basis over terms generally ranging from three to twelve months. Corporate related items and expenses are reflected in Corporate and Other, below. Cost of services and operating expenses consists primarily of production wages, facility costs and other direct costs and selling, general and administrative expenses.

Three months ended March 31, 2005 and 2004

	Three months ended March 31,	
	2005	2004
	amounts in thousands	
Segment Revenue		
Creative services group	$ 74,228	75,166
Media management services group	28,776	25,450
Network services group	71,286	45,327
Corporate and other	—	—
	$174,290	145,943
Segment Operating Cash Flow		
Creative services group	$ 13,051	14,381
Media management services group	3,691	4,687
Network services group	15,006	13,108
Corporate and other	(11,897)	(9,688)
	$ 19,851	22,488

Revenue. Ascent Media's total revenue increased 19.4% for the three months ended March 31, 2005, as compared to the corresponding prior year period. The creative services group revenue decreased $938,000 as a result of lower sound services for feature films and TV and the sluggish commercial market in the U.K. partially offset by increased feature film related revenue driven by the expansion of digital intermediate services, growth in TV post production and changes in foreign currency exchange rates of $408,000. The media management services group revenue increased $3,326,000 as a result of higher lab revenue of $3,439,000 due to the acquisition of Cinetech, higher demand for DVD compression, authoring and menu design services from the large film studios and changes in foreign currency exchange rates of $229,000, partially offset by competitive pressure in the UK. The network services group revenue increased $25,959,000, reflecting the impact of the LPC acquisition of $9,423,000 and changes in foreign currency exchange rates of $593,000. The remaining increase is primarily driven by the timing of various large engineering and systems integration projects and higher installation services activity.

Cost of Services. Ascent Media's costs of services increased 26.3% for the three months ended March 31, 2005, as compared to the corresponding prior year period. The increase is attributable in part to the 2004 acquisitions discussed above which contributed $8,810,000 of the increase in cost of services. The remaining increase is primarily attributable to the change in revenue mix driven by higher systems engineering and integration projects in the network services group resulting in higher production and engineering labor and production material costs. Media management services group cost of services increased $1,495,000. In recent years, expenses for the media management services group have increased at a faster rate than revenue. Media management's projects have become increasingly more integrated, with complex work flows requiring higher levels of production labor and project management. This increase in labor costs, combined with increased spending on continued development of digital technologies and services, has resulted in higher cost of services and decreasing operating cash flow margin.

Selling, General and Administrative. Ascent Media's selling, general and administrative expenses increased 18.6% for the three months ended March 31, 2005, as compared to the corresponding prior year period. This increase is primarily attributable to the impact of the 2004 acquisitions of $4,278,000, the growth in the revenue driving higher labor, facility and selling costs and changes in foreign currency exchange rates of $382,000.

Corporate and Other operating cash flow (which includes DHC corporate general and administrative expenses of $1,242,000 in 2005) decreased $2,209,000 in 2005 primarily due to higher DHC corporate expenses and higher Ascent Media corporate expenses in the U.K. as a result of higher labor, facility and professional services costs.

Depreciation and Amortization. Ascent Media's depreciation and amortization expense increased 4.4% for the quarter ended March 31, 2005, as compared to the prior year period. The increase was driven by an increase in the depreciable base due to capital expenditures and the 2004 acquisitions.

Stock Compensation. In 2001, Ascent Media granted to certain of its officers and employees stock options with exercise prices that were less than the market price of Ascent Media common stock on the date of grant. Those options became exercisable for LMC shares in connection with LMC's acquisition in 2003 of the Ascent Media shares that it did not already own. Ascent Media is amortizing the "in-the-money" value of these options over the 5-year vesting period. Compensation expense for the three months ended March 31, 2005 was comprised of $566,000 related to "in-the-money" stock options offset by $353,000 related to a decline in the value of the underlying stock price used to value employee stock appreciation rights, or SARs. The stock compensation expense recorded for the quarter ended March 31, 2004 related primarily to "in-the-money" stock options of $590,000 offset by $68,000 related to a decline in the value of the underlying stock price used to value employee SARs.

Share of Earnings of Discovery. Our share of earnings of Discovery increased in 2005 due to increases in the net income of Discovery. Discovery's net income improved primarily due to higher revenue.

For a more detailed discussion of Discovery's results of operations, see "—Management's Discussion and Analysis of Financial Condition and Results of Operations of Discovery."

Income Taxes. Our effective tax rate was 35.3% and 26.7% for the three months ended March 31, 2005 and 2004, respectively. Our income tax expense was lower than the federal income tax rate of 35% in 2004 primarily due to a reduction in our valuation allowance.

Years ended December 31, 2004, 2003 and 2002

Ascent Media's consolidated results of operations for the year ended December 31, 2004, include twelve months of results for SIC, approximately nine months of results of LPC and approximately two months of results of Cinetech. The consolidated results for the year ended December 31, 2002 include twelve months of the results of Triumph, which was sold in December 2002.

	Year ended December 31,		
	2004	2003	2002
	amounts in thousands		
Segment Revenue			
Creative services group	$295,841	270,830	275,119
Media management services group	109,982	107,070	105,091
Network services group	225,392	128,203	159,123
Corporate and other	—	—	—
	$631,215	506,103	539,333
Segment Operating Cash Flow			
Creative services group	$ 55,847	43,786	50,150
Media management services group	17,430	22,074	27,682
Network services group	62,163	43,221	45,673
Corporate and other	(38,074)	(34,319)	(34,450)
	$ 97,366	74,762	89,055

Revenue. Ascent Media's total revenue increased 24.7% and decreased 6.2% for the years ended December 31, 2004 and 2003, respectively, as compared to the corresponding prior year. In 2004, the creative services group revenue increased $25,011,000 as a result of higher feature film related revenue driven by the expansion in digital intermediate services in the U.S. and UK, expansion of creative sound services in the UK, growth in television post production activity and changes in foreign currency exchange rates of $6,382,000. The media management services group revenue increased $2,912,000 in 2004 as a result of higher lab revenue of $2,229,000 due to the acquisition of Cinetech, higher demand for DVD mastering services and changes in foreign currency exchange rates of $3,684,000, offset by the commoditization of traditional media services leading to a decline in rates and difficult market conditions primarily in the United Kingdom. While competition for traditional media services remains strong, we are currently unable to predict what impact, if any, this competition will have on rates for these services in the future. The network services group's 2004 revenue increased $97,189,000, reflecting the full year impact of acquisition of SIC of $27,100,000, the nine month impact of the LPC acquisition of $39,619,000 and changes in foreign currency exchange rates of $1,979,000. The remaining increase is driven by the timing of various large systems integration projects, higher network origination and installation projects.

The creative services group revenue decreased $4,289,000 in 2003 due to early television show cancellations, competitive rate pressures in both television and commercial markets, the expiration of market subsidy for high definition services impacting rates, offset by an improved feature film market in sound services, digital intermediate and visual effects services and changes in foreign currency exchange rates of $3,438,000. The media management services group 2003 revenue increased $1,979,000 as a result of higher volumes from the larger movie studios, increased DVD authoring, recording and subtitling activity and changes in foreign currency exchange rates of $2,752,000 offset by fewer mid level and smaller clients due to sluggish media recovery. The network services group revenue decreased $30,920,000 resulting from the divestiture of Triumph in 2002 of $23,118,000, the renegotiation of certain large existing contracts of $14,000,000 and higher volume of systems integration projects in 2002, offset by growth in the network origination business and changes in foreign currency exchange rates of $1,560,000.

Cost of Services. Ascent Media's costs of services increased 26.3% and decreased 6.5% for the years ended December 31, 2004 and 2003, respectively, as compared to the corresponding prior year. The 2004 increase is attributed to the 2004 acquisitions discussed above, which contributed $48,331,000 of the increase in cost of services, higher costs across all of its groups primarily in production material, production personnel and equipment expenses as a result of the increased revenue and production activity noted above and changes in foreign currency exchange rates, which resulted in an increase of $6,321,000. In recent years, expenses for the media management services group have increased at a faster rate than revenue. The projects of the media management services group have become increasingly more integrated, with complex work flows requiring higher levels of production labor and project management. This increase in labor costs, combined with increased spending on continued development of digital technologies and services and the decline in rates for traditional media services noted above, has resulted in higher cost of services and decreasing operating cash flow. The 2003 decrease in cost of services is due to the divestiture of Triumph of $29,072,000, offset by higher costs for the media management services and creative services groups primarily in production material and production personnel expenses and the impact of changes in foreign currency exchange rates of $4,530,000.

Selling, General and Administrative. Ascent Media's selling, general and administrative expenses increased 17.8% and 1.6% for the years ended December 31, 2004 and 2003, respectively, as compared to the corresponding prior year. The 2004 increase is primarily attributable to growth in the business driving higher personnel, facility and selling costs, the impact of the 2004 acquisitions of $5,528,000 and changes in foreign currency exchange rates of $4,222,000. The 2003 increase is primarily due to slightly higher personnel and facility costs in the groups and changes in foreign currency exchange rates of $2,051,000, offset by the divestiture of Triumph, which decreased selling, general and administrative expenses by $3,136,000.

Corporate and Other operating cash flow decreased $3,755,000 in 2004 due to higher corporate expenses in the U.K. from the continued development of corporate infrastructure and acquisition of LPC, higher management incentive plan costs and changes in foreign currency exchange rates of $872,300, offset by lower severance and lease abandonment charges.

Depreciation and Amortization. The increases in depreciation and amortization expense in 2004 and 2003 are due to an increase in the depreciable asset base due to capital expenditures and acquisitions.

Stock Compensation. In 2001, Ascent Media granted to certain of its officers and employees stock options with exercise prices that were less than the market price of Ascent Media common stock on the date of grant. Those options became exercisable for LMC shares in connection with LMC's acquisition in 2003 of the Ascent Media shares that it did not already own. Ascent Media is amortizing the "in-the-money" value of these options over the 5-year vesting period. Compensation expense increased $173,000 and $2,650,000 for the years ended December 31, 2004 and 2003, respectively. Results for the year ended December 31, 2004 primarily included compensation expense of $2,268,000 relating to "in-the-money" stock options and $507,000 increase in the value of the underlying stock price used to value employee stock appreciation rights, or SARs. The expense recorded for the year ended December 31, 2003 related primarily to "in-the-money" stock options of $2,491,000. The income recorded for the year ended December 31, 2002 primarily included $3,102,000 relating to a decline in the value of the SARs, and unearned stock compensation income of $135,000, offset by compensation expense of $3,189,000 relating to "in-the-money" stock options.

Impairment of Goodwill. Ascent Media recorded an $83,718,000 impairment charge in fiscal 2002 resulting from its annual impairment test. Ascent Media obtained estimates of the fair value of its reporting units from an independent valuation consultant, which used income and market approaches to estimate fair value. The impairment charges represented the excess of the carrying value of the goodwill over the estimated fair value. Impairment of goodwill charges in 2004 and 2003 were not significant.

Restructuring Charges. During the year ended December 31, 2003, Ascent Media recorded a restructuring charge of $3,476,000 related to the closing of certain facilities and corresponding reductions in headcount. These restructuring activities were implemented to improve operating efficiencies and effectiveness primarily in its creative services group. Restructuring charges were not significant in 2004 or 2002.

Interest Expense. Interest expense in 2003 and 2002 related primarily to interest on Ascent Media's bank debt and subordinated notes payable due to LMC. In December 2003, Ascent Media repaid all principal and interest under its bank credit facility with cash provided by LMC. In addition, LMC contributed all amounts due under the subordinated notes payable to the equity of Ascent Media. As a result of the cancellation of the bank credit facility and the subordinated notes payable, Ascent Media incurred no interest expense in 2004.

Share of Earnings of Discovery. Our share of earnings of Discovery increased in 2004 and 2003 due primarily to increases in the net income of Discovery. Discovery's net income improved primarily due to higher revenue and improved operating margins. Prior to June 2003, John Hendricks, Discovery's Founder and Chairman, held shares of Discovery common stock that were redeemable on demand. Changes in the redemption value of such shares were recorded by Discovery as adjustments to equity similar to dividends on preferred stock. We included in our share of earnings (losses) of Discovery 50% of the equity adjustments related to the redeemable common stock as those adjustments represented an adjustment in earnings available to common shareholders. The redeemable common stock was redeemed in June 2003. Our share of earnings (losses) of Discovery included gains of $5,700,000 and losses of $7,414,000 for the years ended December 31, 2003 and 2002, respectively, related to changes in the redemption value of the redeemable common stock and other equity transactions.

For a more detailed discussion of Discovery's results of operations, see "—Management's Discussion and Analysis of Financial Condition and Results of Operations of Discovery."

Income Taxes. Our effective tax rate was 34.6% and 21.8% for the years ended December 31, 2004 and 2002, respectively, and was not meaningful in 2003. Our income tax benefit was lower than the federal income tax rate of 35% in 2002 primarily due to the impairment of goodwill, which is not deductible for income tax purposes. In 2003, we had a pre-tax loss of $32,238,000 and we recorded tax expense of $20,156,000 primarily due to a reduction in our valuation allowance and interest expense that is not deductible for tax purposes.

Cumulative Change in Accounting Principle. Effective January 1, 2002, we adopted SFAS No. 142 and, in accordance with its provisions, we recorded a transitional impairment charge of goodwill of $20,227,000 during the first quarter of fiscal 2002. This charge has been reflected as a cumulative effect of a change in accounting principle.

Liquidity and Capital Resources

Historically our primary sources of funds have been from operating activities and borrowed funds under a senior credit facility and a subordinated debt agreement with LMC. During the three months ended March 31, 2005, our primary use of cash was capital expenditures ($20,921,000), which we funded with our available cash and cash generated by operating activities ($11,005,000). For the year ended December, 31, 2004, our primary uses of cash were acquisitions ($44,238,000) and capital expenditures ($49,292,000). We funded these investing activities with cash from operating activities of $84,322,000 and capital contributions from LMC of $30,999,000. Prior to the spin off, LMC has agreed to transfer to one of our subsidiaries $200 million in cash. Subsequent to the spin off, LMC will no longer be a long-term source of liquidity for us. For the foreseeable future, we expect to have sufficient available cash balances and net cash from operating activities to meet our working capital needs and capital expenditure requirements. We intend to seek external equity or debt financing after our spin off in the event new investment opportunities, additional capital expenditures or increased operations require additional funds, but there can be no assurance that we will be able to obtain equity or debt financing on terms that are acceptable to us.

Our ability to seek additional sources of funding depends on our future financial position and results of operations, which, to a certain extent, are subject to general conditions in or affecting our industry and our customers and to general economic, political, financial, competitive, legislative and regulatory factors beyond our control.

We do not have access to the cash Discovery generates from its operations, unless Discovery pays a dividend on its capital stock or otherwise distributes cash to its stockholders. Historically, Discovery has not paid any dividends on its capital stock and we do not have sufficient voting control to cause Discovery to pay dividends or make other payments or advances to us.

Contractual Obligations

Information concerning the amount and timing of required payments under our contractual obligations at December 31, 2004 is summarized below:

	Payments due by Period				
	Less than 1 year	1-3 years	4-5 years	After 5 years	Total
		amounts in thousands			
Contractual Obligations					
Operating leases	$25,682	45,824	37,273	52,523	161,302
Purchase obligations	8,152	—	—	—	8,152
Other	—	—	6,100	—	6,100
Total Contractual Obligations	$33,834	45,824	43,373	52,523	175,554

We have contingent liabilities related to legal proceedings and other matters arising in the ordinary course of business. Although it is reasonably possible we may incur losses upon conclusion of such matters, an estimate of any loss or range of loss cannot be made. In the opinion of management, it is expected that amounts, if any, which may be required to satisfy such contingencies will not be material in relation to the accompanying consolidated financial statements.

New Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payments" ("Statement 123R"). Statement 123R, which is a revision of Statement 123 and supersedes APB Opinion No. 25, establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services, primarily focusing on transactions in which an entity obtains employee services. Statement 123R generally requires companies to measure the cost of employee services received in exchange for an award of equity instruments (such as stock options and restricted stock) based on the grant-date fair value of the award, and to recognize that cost over the period during which the employee is required to provide service (usually the vesting period of the award). Statement 123R also requires companies to measure the cost of employee services received in exchange for an award of liability instruments (such as stock appreciation rights) based on the current fair value of the award, and to remeasure the fair value of the award at each reporting date.

Public companies were originally required to adopt Statement 123R as of the beginning of the first interim period that begins after June 15, 2005. On April 14, 2005, the Securities and Exchange Commission amended the effective date to the beginning of a registrant's next fiscal year, or January 1, 2006 for calendar-year companies, such as us. Accordingly, the provisions of Statement 123R will affect the accounting for all awards granted, modified, repurchased or cancelled after January 1, 2006. The accounting for awards granted, but not vested, prior to January 1, 2006 will also be impacted. The provisions of Statement 123R allow companies to adopt the standard on a prospective basis or to restate all periods for which Statement 123 was effective. We expect to adopt Statement 123R on a prospective basis, and will provide pro forma information as though the standard had been adopted for all periods presented.

While we have not yet quantified the impact of adopting Statement 123R, we believe that such adoption could have a significant effect on our operating income and net earnings in the future.

Critical Accounting Estimates

Valuation of Long-lived Assets and Amortizable Other Intangible Assets. We perform impairment tests for our long-lived assets if an event or circumstance indicates that the carrying amount of our long-lived assets may not be recoverable. In response to changes in industry and market conditions, we may also strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses. Such activities could result in impairment of our long-lived assets or other intangible assets. We are subject to the possibility of impairment of long-lived assets arising in the ordinary course of business. We regularly consider the likelihood of impairment and recognize impairment if the carrying amount of a long-lived asset or intangible asset is not recoverable from its undiscounted cash flows in accordance with SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets. Impairment is measured as the difference between the carrying amount and the fair value of the asset. We use both the income approach and market approach to estimate fair value. Our estimates of fair value are subject to a high degree of judgment. Accordingly, any value ultimately derived from our long-lived assets may differ from our estimate of fair value.

Valuation of Goodwill and Non-amortizable Other Intangible Assets. We assess the impairment of goodwill annually and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include significant underperformance to historical or projected future operating results, substantial changes in our strategy or the manner of use of our assets, and significant negative industry or economic trends. Effective January 1, 2002, we adopted SFAS No. 142. In accordance with its provisions, during the first quarter of fiscal year 2002, we recorded a transitional impairment charge of $20,227,000 against goodwill related to our entertainment television reporting unit, which is part of our creative service group. Such charge was reflected as a cumulative effect of a change in accounting principle. Additionally, as a result of our annual impairment testing, we recorded a goodwill impairment charge of $83,718,000 during the fourth quarter of fiscal 2002. Of this impairment charge, $56,818,000 of impairment related to our entertainment television reporting unit and $26,900,000 related to our commercial television reporting unit, both part of our creative services group. As a result of our annual impairment testing, during fiscal 2004 and 2003, we recorded goodwill impairment charges of $51,000 and $562,000, respectively. The impairment charge in fiscal 2004 was in Ascent Media's audio reporting unit and the impairment charge in fiscal 2003 was in Ascent Media's entertainment television reporting unit, both of which are part of Ascent Media's creative services group. Fair value of each reporting unit was determined through the use of an outside independent valuation consultant. The consultant used both the income approach and market approach in determining fair value.

Valuation of Trade Receivables. We must make estimates of the collectibility of our trade receivables. Our management analyzes the collectibility based on historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms. We record an allowance for doubtful accounts based upon specifically identified receivables that we believe are uncollectible. In addition, we also record an amount based upon a percentage of each aged category of our trade receivables. These percentages are estimated based upon our historical experience of bad debts. Our trade receivables balance was $151,120,000, net of allowance for doubtful accounts of $12,104,000, as of December 31, 2004.

Valuation of Deferred Tax Assets. In accordance with SFAS No. 109, Accounting for Income Taxes, we review the nature of each component of our deferred income taxes for reasonableness. We have determined that it is more likely than not that we will not realize a portion of our tax benefits associated with certain cumulative net operating loss carry forwards and impairment reserves, and as such, we have reserved for a portion of our deferred income tax assets. The valuation allowance as of December 31, 2004 and 2003 was $76,452,000 and $101,470,000, respectively.

Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Risk

We continually monitor our economic exposure to changes in foreign exchange rates and may enter into foreign exchange agreements where and when appropriate. Substantially all of our foreign transactions are denominated in foreign currencies, including the liabilities of our foreign subsidiaries. Although our foreign transactions are not generally subject to significant foreign exchange transaction gains or losses, the financial statements of our foreign subsidiaries are translated into United States dollars as part of our consolidated financial reporting. As a result, fluctuations in exchange rates affect our financial position and results of operations.

Management's Discussion and Analysis of Financial Condition and Results of Operations of Discovery

Overview

We hold a 50% ownership interest in Discovery and account for this investment using the equity method of accounting. Accordingly, in our financial statements we record our share of Discovery's net income or loss available to common shareholders and reflect this activity in one line item in the statement of operations as "Share of earnings (losses) of Discovery." The following financial information of Discovery for the three months ended March 31, 2005 and March 31, 2004 and the years ended December 31, 2004, 2003 and 2002 and related discussion is presented to provide the reader with additional analysis of the operating results and financial position of Discovery. Because we do not control the decision-making process or business management practices of Discovery, we rely on Discovery to provide us with financial information prepared in accordance with GAAP that we use in the application of the equity method. The information included in this section should be read in conjunction with the audited financial statements of Discovery for the year ended December 31, 2004 included elsewhere herein. The following discussion and analysis of Discovery's operations and financial position has been prepared based on information that we receive from Discovery and represents our views and understanding of their operating performance and financial position based on such information. Discovery is not a separately traded public company, and we do not have the ability to cause Discovery's management to prepare their own management's discussion and analysis for our purposes. Accordingly, we note that the material presented in this section might be different if Discovery's management had prepared it.

Three months ended March 31, 2005 and 2004

The following discussion of Discovery's results of operations is presented on a consolidated basis. In order to provide a better understanding of Discovery's operations, we have also included a summarized presentation of revenue and operating cash flow of Discovery's three operating groups: Discovery networks U.S., or U.S. networks, Discovery networks international, or international networks, and Discovery commerce, education & other. See "Management's Discussion and Analysis of Financial Condition and Results of Operations of Discovery Holding—Operating Cash Flow" for our definiton of operating cash flow.

The U.S. networks is Discovery's largest division. It owns and operates 12 cable and satellite channels and provides distribution and advertising sales services for BBC America. International networks manages a portfolio of channels, led by the Discovery Channel and Animal Planet brands, that are distributed in virtually every pay-television market in the world via an infrastructure that includes major operational centers in London, Singapore, New Delhi and Miami. Discovery commerce, education & other includes Discovery's retail chain store operations and other direct consumer marketing activities as well as Discovery education which was recently formed to manage Discovery's distribution of education content.

Consolidated Results

	Three months ended March 31, 2005	Three months ended March 31, 2004
	amounts in thousands	
Revenue		
Advertising	$ 273,386	262,284
Subscriber fees	281,642	227,297
Other	46,443	37,781
Total revenue	601,471	527,362
Expenses		
Cost of revenue	(218,259)	(181,737)
Selling, general & administrative ("SG&A") expense	(234,758)	(208,208)
Operating cash flow	148,454	137,417
Expenses arising from long-term incentive plans	(22,867)	(28,780)
Depreciation & amortization	(28,821)	(30,833)
Operating income	96,766	77,804
Other Income (Expense)		
Interest expense, net	(44,908)	(40,734)
Unrealized gains from derivative instruments, net	12,253	1,441
Minority interests in consolidated subsidiaries	2,252	(2,793)
Other	12,895	468
Income before income taxes	79,258	36,186
Income tax expense	(33,629)	(15,335)
Net income	$ 45,629	20,851

Business Segment Results

	Three months ended March 31,	
	2005	2004
	amounts in thousands	
Revenue		
U.S. networks	$416,126	381,015
International networks	158,916	127,000
Discovery commerce, education & other	26,429	19,347
Total revenue	$601,471	527,362
Operating Cash Flow		
U.S. networks	$147,437	139,209
International networks	24,549	16,295
Discovery commerce, education & other	(23,532)	(18,087)
Total operating cash flow	$148,454	137,417

Note: Discovery commerce, education & other includes intercompany eliminations.

Revenue. Discovery's consolidated revenue increased 14% for the three months ended March 31, 2005, as compared to the corresponding prior year period. Increased revenue was primarily due to a 24% increase in subscriber fee revenue. Advertising revenue increased 4% during the same period. Other revenue increased 23% due to increased commerce revenue and growth in Discovery's education business.

Subscriber fee revenue grew 24% and 23% at the U.S. networks and the international networks, respectively, for the three months ended March 31, 2005, as compared to the corresponding prior year period. The increase in subscriber fees at the U.S. networks is due to a 14% increase in paying subscription units combined with lower launch support amortization. Free viewing periods related to a number of U.S. networks, principally networks that are carried on the digital tier, expired in 2004 and Discovery is now recognizing subscriber fees for those networks. U.S. networks subscriber fee increases were helped by reduced launch fee amortization, a contra-revenue item, as a result of extensions of certain affiliation agreements. Launch amortization at the U.S. networks declined from $25.8 million during the first quarter of 2004 to $20.2 million in 2005 primarily due to these extensions. Increases in subscriber fees at the international networks were driven principally by increases in subscription units in Europe and the international joint venture channels due to recently launched networks.

The increase in advertising revenue, which includes revenue from paid programming, was primarily due to a 40% increase at the international networks. More than half of the international networks' advertising revenue is generated by its operations in the U.K. and Europe. The increase in international networks advertising revenue was due primarily to higher advertising rates and audience growth in the U.K., combined with advertising revenue generated by new channels launched in Europe. Advertising revenue at the U.S. networks was essentially flat as higher advertising rates at substantially all of the U.S. networks were offset by lower audience delivery at certain networks. Paid programming, where Discovery sells blocks of time primarily for infomercials that are aired during the overnight hours on certain networks, represented 7% and 8% of total advertising revenue for the three months ended March 31, 2005 and 2004, respectively.

The increase in other revenue was primarily due to an increase in education revenue due to growth in the business and acquisitions combined with a 12% increase in store revenue. The increase in store revenue was due to a 20% increase in same store sales offset by a 7% decrease in the average number of stores.

Cost of Revenue. Cost of revenue increased 20% for the three months ended March 31, 2005 as compared to the corresponding prior year period. As a percent of revenue, cost of revenue was 36% and 35% for the three months ended March 31, 2005 and 2004, respectively. This increase resulted primarily from higher programming expense due to continued investment across all U.S. networks in original productions and high profile specials. At the international networks, Discovery began investing in an initiative to highlight and strengthen its lifestyles category, particularly in Europe during the fourth quarter of 2004, which has resulted in increased programming costs.

SG&A Expenses. SG&A expense increased 13% for the three months ended March 31, 2005, as compared to the corresponding prior year period. Within the different groups, SG&A expenses increased 3%, 23% and 42% at the U.S. networks, international networks and Discovery commerce, education & other, respectively. The increase at the international networks was caused by increases in personnel expense resulting from adding headcount as the business expanded combined with higher marketing expense associated with branding and awareness efforts in association with the lifestyles category initiative. The increase in SG&A expenses at Discovery commerce, education & other is primarily due to the growth in Discovery's education business, resulting from both acquisitions and organic growth.

Expenses Arising from Long-term Incentive Plans. Expenses arising from long-term incentive plans are related to Discovery's unit-based, long-term incentive plan, or LTIP, for its employees who meet certain eligibility criteria. Units are awarded to eligible employees and generally vest at a rate of 25% per year. Upon exercise, participants receive a cash payment for the increase in value of the units from the unit value on the date of issuance. Unit value is determined annually by the year over year change in Discovery's aggregate equity value as estimated by an external investment firm, using a consistent methodology. The appreciation in unit value of LTIP awards outstanding is recorded as compensation expense over the vesting periods. The aggregate number of units that are currently authorized to be granted under the LTIP plan approximates an 8% sharing in the change in Discovery's equity value. The 21%, or $5,913,000, decrease in LTIP expense in 2005 is the result of units being exercised in 2004, which increased the weighted average exercise price of vested options.

Depreciation and Amortization. The decrease in depreciation and amortization for the quarter ended March 31, 2005 is primarily due to a decrease in the depreciable asset base resulting from a reduction in the number of retail stores.

Other Income and Expense

Interest Expense. The increase in interest expense for the quarter ended March 31, 2005 is primarily due to a higher average outstanding debt balance during the first quarter of 2005, as compared to the first quarter of 2004, combined with an increase in average interest rates.

Unrealized Gains from Derivative Instruments, net. Unrealized gains from derivative transactions relate primarily to Discovery's use of derivative instruments to modify its exposure to interest rate fluctuations on its debt. These derivative contracts include a combination of swaps, caps, collars and other structured instruments. As a result of unrealized mark to market adjustments, Discovery recognized $12,253,000 and $1,441,000 in gains on these instruments during the quarters ended March 31, 2005 and 2004, respectively. The foreign exchange hedging instruments used by Discovery are spot, forward and option contracts. Additionally, Discovery enters into forward contracts to hedge non-dollar denominated cash flows and foreign currency balances. The unrealized gains were primarily driven by increases in interest rates during the quarter resulting in an increase in value of the underlying derivatives.

Minority Interests in Consolidated Subsidiaries. Minority interest represents increases and decreases in the estimated redemption value of mandatory redeemable interests in subsidiaries which are initially recorded at fair value. Discovery accretes or decretes the mandatorily redeemable interest in a subsidiary to its estimated redemption value through the redemption date. Based on its most recent estimates, Discovery recorded a net minority interest decretion of $1,650,000 during the three months ended March 31, 2005, compared to a net minority accretion of $2,793,000 for the three months ended March 31, 2004.

Other. Other represents Discovery's share of earnings (losses) of affiliates and gains (losses) on sales of investments. During the first quarter of 2005, Discovery recognized a gain of $11,961,000 related to a sale of an available for sale investment.

Income Taxes. Discovery's effective tax rate was 42% for both the three months ended March 31, 2005 and 2004, respectively. Discovery's effective tax rate differed from the federal income tax rate of 35% primarily due to foreign and state taxes.

Years ended December 31, 2004, 2003 and 2002

The following discussion of Discovery's results of operations is presented in two parts to assist the reader in better understanding Discovery's operations. The first section is an overall discussion of Discovery's consolidated operating results. The second section includes a more detailed discussion of revenue and operating cash flow activity of Discovery's three operating groups: Discovery networks U.S., or U.S. networks, Discovery networks international, or international networks, and Discovery commerce, education & other.

Consolidated Results

	Years ended December 31,		
	2004	2003	2002
	amounts in thousands		
Revenue			
Advertising	$1,133,807	1,010,585	829,936
Subscriber fees	976,362	747,927	646,500
Other	255,177	236,535	240,339
Total revenue	2,365,346	1,995,047	1,716,775
Expenses			
Cost of revenue	(846,316)	(751,578)	(699,737)
SG&A expense	(856,340)	(735,017)	(638,405)
Operating cash flow	662,690	508,452	378,633
Expenses arising from long-term incentive plans	(71,515)	(74,119)	(96,865)
Depreciation & amortization	(129,011)	(120,172)	(112,841)
Gain on sale of patents	22,007	—	—
Operating income	484,171	314,161	168,927
Other Income (Expense)			
Interest expense, net	(167,420)	(159,409)	(163,315)
Unrealized gains (losses) from derivative instruments, net	45,540	21,405	(11,607)
Minority interests in consolidated subsidiaries	(54,940)	(35,965)	(45,977)
Other	2,470	(2,170)	(6,141)
Income (loss) before income taxes	309,821	138,022	(58,113)
Income tax (expense) benefit	(141,799)	(74,785)	10,057
Net income (loss)	$ 168,022	63,237	(48,056)

Revenue. Discovery's consolidated revenue increased 19% and 16% for the years ended December 31, 2004 and 2003, respectively, as compared to the corresponding prior year. Increased revenue was primarily due to increases of 31% and 16% in subscriber fee revenue for 2004 and 2003, respectively, as well as increases of 12% and 22% in advertising revenue for the same periods. Changes in other revenue did not have a significant impact on the overall revenue increase for either year. Increased subscriber fee revenue is primarily due to contractual rate increases, subscriber growth and a reduction in launch support amortization as certain affiliation agreements were extended. Subscriber fees also benefited from contractual arrangements whereby certain subscribers that were previously covered under free carriage periods with distributors were converted to paying subscribers. Increases in advertising revenue, which includes revenue from paid programming, were primarily due to increased advertising rates at the U.S. networks combined with positive developments in international networks advertising sales resulting from continued growth in subscription units. Paid programming, where Discovery sells blocks of time primarily for infomercials that are aired during the overnight hours on certain networks, represented 6%, 6% and 7% of total advertising revenue for the years ended December 31, 2004, 2003, and 2002, respectively.

Cost of Revenue and SG&A Expense. Consolidated operating expenses, which for purposes of this discussion includes cost of revenue and SG&A expenses, increased 15% and 11% for the years ended December 31, 2004 and 2003, respectively, as compared to the corresponding prior year. Operating expenses increased primarily as a result of higher programming costs for Discovery's U.S. networks as well as higher personnel and marketing costs at both the U.S. and international networks. Expenses related to programming, personnel and marketing made up approximately 64% of Discovery's consolidated operating expenses in 2004. Historically, these costs have not increased at the same rate as revenue due to the benefits of scale economics, combined with ongoing cost management initiatives, as described below. As a result, Discovery has been able to increase its operating cash flow as a percent of revenue from 22% in 2002 to 25% in 2003 and 28% in 2004.

Expenses Arising from Long-term Incentive Plans. Expenses arising from long-term incentive plans are related to Discovery's unit-based, long-term incentive plan, or LTIP, for its employees who meet certain eligibility criteria. Units are awarded to eligible employees and generally vest at a rate of 25% per year. Upon exercise, participants receive a cash payment for the increase in value of the units from the unit value on the date of issuance. Unit value is determined by the year over year change in Discovery's aggregate equity value as estimated by an external investment firm, using a consistent methodology. The appreciation in unit value of LTIP awards outstanding is recorded as compensation expense over the vesting periods. The aggregate number of units that are currently authorized to be granted under the LTIP plan approximates an 8% sharing in the change in Discovery's equity value.

Depreciation and Amortization. The increase in depreciation and amortization in both 2004 and 2003 is due to an increase in intangible assets resulting from acquisitions combined with increases in Discovery's depreciable asset base resulting from capital expenditures.

Gain on Sale of Patents. In 2004, Discovery recorded a gain on the sale of certain of its television technology patents. The $22 million gain represents the sale price less the costs incurred to sell the patents. The cost of developing the technology had been expensed in prior years to SG&A expense. Discovery does not expect a significant amount of income from patent sales in the future.

Ongoing Cost Management Initiatives. Discovery has an extensive library of programming and footage that provides a high quality programming resource for launching new services quickly while minimizing incremental costs. Existing programming is re-edited and updated to provide topical programming content in a cost-effective manner. In addition, Discovery has expanded its internal post-production capacity to contain programming costs further. Marketing efficiencies have been achieved through the use of internal promotion time. Growth in personnel has been contained through economies of scale and workflow improvements.

Other Income and Expense

Interest Expense. The increase in interest expense in 2004 is primarily due to higher levels of outstanding debt in 2004 as well as a slight increase in interest rates. Interest expense was lower in 2003, as compared with 2002 due primarily to a modest reduction in average interest rates.

Unrealized Gains (Losses) from Derivative Instruments, net. Unrealized gains and losses from derivative transactions relate, primarily, to Discovery's use of derivative instruments to modify its exposure to interest rate fluctuations on its debt. These instrument contracts include a combination of swaps, caps, collars and other structured instruments. At December 31, 2004, the variable to fixed interest rate instruments have a notional principal amount of $800,000,000 and have a weighted average interest rate of 5.93%. At December 31, 2004, the fixed to variable interest rate agreements have a notional principal amount of $240,000,000 and have a weighted average interest rate of 6.46%. As a result of unrealized mark to market adjustments, Discovery recognized $44,060,000, $21,548,000 and $(13,375,000) in gains (losses) on these instruments during the years ended December 31, 2004, 2003 and 2002, respectively. The foreign exchange hedging instruments used by Discovery are spot, forward and option contracts. Additionally, Discovery enters into forward contracts to hedge non-dollar denominated cash flows and foreign currency balances. At December 31, 2004, the notional amount of foreign exchange derivative contracts was $92,800,000.

Minority Interests in Consolidated Subsidiaries. Minority interest represents increases and decreases in the estimated redemption value of mandatory redeemable interests in subsidiaries which are initially recorded at fair value.

Income Taxes. Discovery's effective tax rate was 46%, 54% and 17% for 2004, 2003 and 2002, respectively. Discovery's effective tax rate differed from the federal income tax rate of 35% primarily due to foreign and state taxes.

Business Segment Results

As noted above, we have classified Discovery's operations into three groups: U.S. networks, international networks and Discovery commerce, education & other.

	Years ended December 31,		
	2004	2003	2002
	amounts in thousands		
Revenue			
U.S. networks	$1,605,032	1,351,336	1,121,149
International networks	583,062	473,890	409,221
Discovery commerce, education & other	177,252	169,821	186,405
Total revenue	$2,365,346	1,995,047	1,716,775
Operating Cash Flow			
U.S. networks	$ 599,954	486,580	416,946
International networks	97,073	68,439	15,744
Discovery commerce, education & other	(34,337)	(46,567)	(54,057)
Total operating cash flow	$ 662,690	508,452	378,633

Note: Discovery commerce, education & other includes intercompany eliminations.

U.S. Networks

	Years ended December 31,		
	2004	2003	2002
	amounts in thousands		
Revenue			
Advertising	$ 943,454	865,239	717,684
Subscriber fees	611,458	444,953	384,614
Other	50,120	41,144	18,851
Total revenue	1,605,032	1,351,336	1,121,149
Cost of revenue	(501,313)	(420,251)	(349,898)
SG&A expense	(503,765)	(444,505)	(354,305)
Operating cash flow	$ 599,954	486,580	416,946

Revenue

In 2004, advertising revenue increased 9%, subscriber fees increased 37% and other revenue increased 22%. Substantially all of the U.S. networks saw increases in advertising revenue. Such increases were principally due to higher advertising sell-out and rates. While overall subscription units increased 5%, subscriber fees increased at a higher rate primarily due to contractual rate increases at most U.S. networks combined with a 14% increase in paying subscribers. Free viewing periods related to a number of U.S. networks, principally networks that are carried on the digital tier, expired in 2004 and Discovery began to recognize subscriber fees for those networks. Subscriber fee increases were also helped by reduced launch fee amortization, a contra-revenue item, as a result of extensions of certain affiliation agreements. Launch amortization declined from $118,888,000 in 2003 to $93,763,000 in 2004 primarily due to these extensions. Other revenue primarily increased as a result of increased revenue from Discovery's representation of BBC America.

Revenue increased 21% in 2003 primarily due to a 21% increase in advertising revenue and a 16% increase in subscriber fees. Higher advertising revenue was primarily attributable to gains in rates and ratings across nearly all of the U.S. networks. Increased subscriber fees were due to a 20% increase in cumulative subscription units as well as a modest reduction in launch support amortization from $122,429,000 to $118,888,000. Other revenue increased as a result of increased revenue from Discovery's representation of BBC America due to increased distribution of that channel.

The U.S. networks group has five networks (Discovery Channel, TLC, Animal Planet, Travel Channel and Discovery Health), which are currently, or pursuant to contractual launch commitments are reasonably anticipated to be, among the most widely-distributed networks in the U.S. pay television industry. Discovery's other U.S. networks are distributed primarily in DTH systems and the digital packages of cable systems and have been successful in maximizing their distribution within this more limited universe. There is, however, no guarantee that these digital networks will ever be able to gain the distribution levels or advertising rates of Discovery's five major networks. Discovery's contractual arrangements with U.S. distributors are renewed or renegotiated from time to time in the ordinary course of business. Discovery has renewed long-term contracts with distributors representing approximately 75% of the U.S. pay television universe, the majority of which have terms through 2009. Only 1% of the U.S. networks aggregate subscription units are carried under agreements that are either expired or expire in the next twelve months.

Cost of Revenue and SG&A Expense

In 2004, cost of revenue increased 19%, due primarily to an increase in programming costs. Programming expense increased due to continued investment across all U.S. networks in original productions and high profile specials. The U.S. networks increased the number of hours related to first run premiere programming and exhibited one high profile special production in each quarter on the Discovery Channel. SG&A expenses increased 13% due to an increase in marketing and other variable expenses. Marketing expense increased as the company continued to invest in brand promotion, gaining audience share in a highly competitive market, and securing quality distribution of the U.S. networks. Other variable expenses increased as a result of the increase in revenue.

In 2003, cost of revenue increased 20%, primarily due to a 19% increase in programming costs. The increase in programming costs was primarily due to Discovery's renewed emphasis on original productions with a significant increase in the number of programming hours dedicated to first run premiere programming. SG&A expense increased 25% due to a 16% increase in personnel costs and a 41% increase in marketing costs. Personnel costs increased across all of the U.S. networks resulting from the growth of the division. Marketing costs increased at most of the U.S. networks as Discovery invested in campaigns designed to raise channel awareness and increase ratings.

International Networks

	Years ended December 31,		
	2004	2003	2002
	amounts in thousands		
Revenue			
Advertising	$ 190,185	144,971	112,110
Subscriber fees	364,911	302,973	261,887
Other	27,966	25,946	35,224
Total revenue	583,062	473,890	409,221
Cost of revenue	(258,108)	(236,555)	(225,595)
SG&A expenses	(227,881)	(168,896)	(167,882)
Operating cash flow	$ 97,073	68,439	15,744

Revenue

In 2004, Discovery's international networks revenue increased 23% primarily as a result of a 20% increase in subscriber fees and a 31% increase in advertising revenue. Increases in subscriber fees were driven principally by increases in subscription units in Europe and the international joint venture channels. More than half of the international networks' advertising revenue is generated by its operations in the United Kingdom with the remainder principally coming from Asia, Latin America and Continental Europe. Specific reasons for the increase in advertising revenue include: (1) higher advertising rates and higher viewership ratings in the U.K. and Latin America and (2) increased distribution in Asia.

In 2003, revenue increased 16% as a result of a 16% increase in subscriber fees and a 29% growth in advertising revenue offset slightly by a decrease in other revenue. Subscriber fees increased due to subscription unit growth of 24% and subscription rate increases on paying subscription units across substantially all of its regions. Subscriber fee revenue grew at a slower rate than the overall increase in subscription units due to many of the new subscription units initially being in free preview status. Advertising revenue increased as a result of audience growth in the U.K. and Europe partially offset by weakness in Latin America. Other revenue decreased due to a reduction in programming sales to third parties.

During the years ended December 31, 2004, 2003 and 2002, the international networks group's fluctuations in revenue and operating cash flow were impacted favorably by changes in the exchange rates of various foreign currencies. In the event the U.S. dollar strengthens against certain foreign currencies in the future, the international networks group's revenue and operating cash flow will be negatively impacted. Had there been no impact from changes in exchange rates of foreign currencies, the international networks would have increased revenue and operating cash flow 16% and 35% during the year ended December 31, 2004 and 9% and 208% during the year ended December 31, 2003.

Cost of Revenue and SG&A Expense

In 2004, cost of revenue increased primarily due to a 2% increase in programming costs combined with the effects of foreign currency fluctuations. Discovery's ability to leverage its U.S. programming library in international markets at minimal translation costs has helped reduce programming expense as a percentage of revenue. SG&A expense for Discovery's international networks increased 35% due to a 20% increase in personnel costs and a 40% increase in marketing expenses. Increases in personnel expense are the result of adding headcount as the business expands particularly in the U.K. and Europe. Higher marketing expenses were experienced across all of the regions as the division continues to brand and create awareness for the channels. Discovery also began investing in an initiative to highlight and strengthen its lifestyles category, particularly in Europe, in the fourth quarter of 2004. Increases in other expenses were primarily due to the continued expansion of the business and unfavorable foreign currency exchange rates.

Cost of revenue increased 5% in 2003 due to small increases in programming expense due primarily to the effects of foreign currency fluctuations. SG&A expenses were relatively consistent, only increasing 1% during the year ended December 31, 2003. Relatively modest increases in expense items despite the larger increase in revenue reflects the benefits of scale economics achieved by the international networks in 2003.

Discovery's international businesses are subject to a number of risks including fluctuation in currency exchange rates and political unrest. In addition, the economies in many of the regions where Discovery's international businesses operate have recently experienced moderate to severe recessionary conditions, including among others, Argentina, Germany and Japan. These recessionary conditions have strained consumer and corporate spending and financial systems and financial institutions in these areas. As a result, Discovery's operations in these areas have experienced a reduction in consumer spending and demand for services.

Discovery Commerce, Education & Other

	Years ended December 31,		
	2004	2003	2002
	amounts in thousands		
Revenue			
Other	$ 202,586	189,666	193,641
Eliminations	(25,334)	(19,845)	(7,236)
Total revenue	177,252	169,821	186,405
Cost of revenue	(86,895)	(94,772)	(123,779)
SG&A expense	(124,694)	(121,616)	(116,683)
Operating Cash Flow	$ (34,337)	(46,567)	(54,057)

The majority of the financial results included in Discovery commerce, education & other are derived from Discovery's chain of retail stores in the United States. Over the past several years, pursuant to an initiative that began at the beginning of 2003, Discovery has closed retail outlets that were not profitable. The average number of retail stores was 122, 144 and 167 for the years ended December 31, 2004, 2003 and 2002, respectively.

Revenue

The increase in revenue of 4% for Discovery commerce, education & other for the year ended December 31, 2004 was primarily due to an increase in education revenue due to acquisitions, offset by a 5% decrease in store revenue. The decrease in store revenue was due to the closure of unprofitable stores, which resulted in a 15% reduction in the average number of stores. Discovery began an initiative in 2003 to close stores that were not profitable. Lower revenue as a result of fewer stores was partially offset by a 4% improvement in same store sales.

In 2003, overall revenue declined slightly due to 14% fewer retail stores, offset by a 30% increase in sales through Discovery's website and catalog. Store revenue was also negatively impacted by a 1% decline in same store sales.

Cost of Revenue and SG&A Expense

In 2004, cost of revenue declined 8% due to fewer stores. This decrease was offset slightly by disposals of obsolete inventory. SG&A expenses increased due to additional expenses associated with acquired businesses within Discovery's education division combined with store closure costs offset by a reduction in store personnel costs due to lower headcount at the stores as a result of store closures throughout 2004 and 2003.

In 2003, cost of revenue declined as a result of fewer stores as well as improvements in gross margin from changes in product mix. In 2003, Discovery increased its focus on proprietary products which typically yield higher gross margins.

As a result of certain acquisitions and other initiatives in 2004 Discovery believes it will incur additional operating losses in its education division, which could be significant over the next several years.

Liquidity & Capital Resources

Discovery generated $30,152,000 of cash from operations during the three months ended March 31, 2005 and used $202,435,000 of cash from operations during the comparable prior year period. The company's source of cash from operations during the three months ended March 31, 2005 was its operating cash flow offset by interest expense of $44,908,000 and working capital fluctuations. During the three months ended March 31, 2004, the company's use of cash from operations resulted from operating cash flow less cash paid for interest expense, working capital fluctuations and payments associated with the company's long-term incentive plan in the amount of $207,504,000.

During the three months ended March 31, 2005, Discovery paid $92,874,000 to acquire mandatorily redeemable securities related to minority interests in certain consolidated subsidiaries. Discovery also spent $35,459,000 on capital expenditures during the period. Cash flows used for investing purposes during the first quarter of 2004 were not significant.

In addition to cash provided by operations, Discovery funds its activities with proceeds borrowed under various debt facilities, including a term loan, a revolving loan facility and various senior notes payable. During the three months ended March 31, 2005 and 2004, net incremental borrowings under debt facilities aggregated $102,000,000 and $254,000,000, respectively. Total commitments of these